



Texas County and District Retirement System

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RQ-643

December 1, 1993

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Honorable Dan Morales
Attorney General of Texas
P. O. Box 12548, Capital Station
Austin, Texas 78711-2548

Dear Mr. Attorney General:

The statutes governing the Texas County and District Retirement System authorize the Board of Trustees of the System (Section 845.301 Government Code) to:

... invest and reinvest the assets of the retirement system ... in:

(1) interest-bearing bonds or other evidences of indebtedness of this state, a county, school district, city or other municipal corporation of this state, the United States, or an authority or an agency of the United States;

(2) securities for which the United States or any authority or agency of the United States guarantees the payment of principal and interest;

(3) interest-bearing bonds, notes, or other evidences of indebtedness that are issued by a company:

(A) incorporated in the United States and that are rated "A" or better by one or more nationally recognized rating agencies approved by the board; or

(B) in whose stock the retirement system may invest as provided by Subdivision (4);

(6) real estate mortgage investment conduit securities (REMICs) or other participation certificates issued by the Federal National Mortgage Corporation or by the Federal Home Loan Mortgage Corporation, evidencing an undivided beneficial interest in pools of real estate mortgage notes that are guaranteed as to payment of principal and interest by the issuer, or by any agency, authority or instrumentality of the United States, and that are to be held in trust by the issuer for the benefit of the certificate holder.

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Heretofore, the Board of Trustees has invested funds of TCDRS in securities in certificate form payable to bearer or registered to TCDRS, or, as to United States Treasury Bonds since 1988 in "Treasury Direct" bonds, a special type of book-entry securities hereinbelow more fully described.

New issue securities in certificate form are disappearing in terms of supply, due to development of the electronic book entry methods or systems hereinbelow described, and the manifold advantages afforded to both borrowers and investors by those methods.

Present electronic book-entry securities involve three methods, which have similarities and differences.

First Method. The majority of new corporate debt securities, as well as those issued by this State and by most of its municipalities, are now issued in the form and method described in the October 10, 1989 report of the State Auditor to the Legislative Audit Committee (a copy of which is attached) as "Book-Entry Only (Electronic Form)." As more fully explained in that report, most borrower corporations today will issue "book-entry only" bonds, utilizing the services of the "Depository Trust Company" of New York City, a securities certificate depository established by 150 "participant" banks, brokers, and stock exchanges (as stockholders), each of whom maintains accounts with the Depository Trust Company. If X corporation borrows \$50,000,000 due twenty years from date at 7% interest due semi-annually, it will execute a single bond certificate (sometimes called a "global" certificate) for the entire amount, payable to the Depository Trust Company (or its nominee);¹ the issue will be subscribed by brokers who are participants of the Depository Trust Company, which on closing, receives and holds the certificate, and credits the respective accounts of the underwriting participants with the fractional amount to which that participant is entitled. Subsequent transfers may only be made from one participant's account to that of another participant.

In consequence, an investor who buys from a participant broker \$1,000,000 of the issue receives credit as owner of that amount of the bond in the accounts of the broker, but the broker

¹One "global" certificate is issued for each year in which the debt matures.

remains (so far as the Depository Trust Company is concerned) the owner of the bonds. Or, the investor (e.g., TCDRS) can arrange to have a participant bank pay the broker for the bonds, and in that event, the bonds will be transferred on the books of the Depository Trust Company from the brokers account to that of the bank, as owner; and the investor receives a safekeeping receipt from the bank as custodian for the investor, or receives an account statement from the bank acknowledging the investor as beneficial owner.²

Second Method. Most securities of agencies and instrumentalities of the United States are now issued in book-entry only form, utilizing the Federal Reserve Bank holder of the securities (essentially as the securities depository), which may only be held by (and transferred between) member banks of the Federal Reserve System (essentially as "participants"). If an investor buys such agency bonds from a broker (who is beneficial owner through his bank, which is shown on the records of the Federal Reserve Bank as owner), payment is made to the broker's bank by the buyer's bank (a cash account transfer), and the security is transferred on the books of the Federal Reserve Bank to the account of the buyer's bank, which is now shown as owner of the bond; and the investor-buyer receives from his member bank a safekeeping receipt or statement of account reflecting its acknowledgment that the investor is the beneficial owner of the bond.³

²In 1983, there were nine stock and bond certificate depositories registered by the SEC (Auditor's report, supra, p.8) and at least three are in current operation, although Depository Trust Company is by far the largest. The advantages of electronic book-entry only bonds to the borrower are discussed in the attached State Auditor's report; the advantages and problems from the standpoint of investors are discussed in the State Auditor's "Report to the Legislative Audit Committee On the Feasibility of Using the Depository Trust Company Book Entry System for State Investments" (dated May 4, 1987). The procedures involving such bonds, and some of the legal relationships arising therefrom, are discussed in State of Delaware v. State of New York, U.S. 113 Sup.Ct. 1950 (1993), in which the State of Texas was also a party.

³Other federal agencies issue securities as described in method 1, using the Depository Trust Company or the Participants Trust Company as securities depository.

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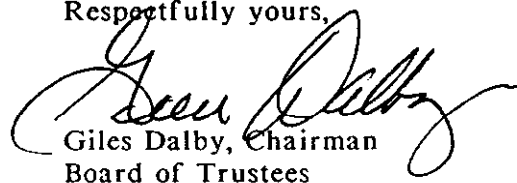
Third Method. The "Treasury-Direct" U. S. Treasury bonds above mentioned constitute the third variation of electronic book-entry only securities. As with agency securities, the Federal Reserve Bank serves essentially as the securities depository, but under U.S. Treasury regulations, the beneficial owner of such bonds is given its own "Treasury Direct" account at the Federal Reserve Bank, and receives statements from the Federal Reserve Bank reflecting such ownership of the bonds by the investor. No financial intermediary is involved.⁴

The Board of Trustees respectfully requests your opinion on the following questions:

1. Does the Board of Trustees have authority under existing statutes to utilize banks or other financial intermediaries [as defined in §8.313(d), Uniform Commercial Code] to purchase and hold securities of corporations and agencies of the U.S. government that are payable only to the Depository Trust Company (or its nominee), which depository on its records recognizes only a "participant" bank as owner, and TCDRS would receive a safekeeping receipt or account statement from the bank acknowledging TCDRS as beneficial owner?

2. Does the Board of Trustees have authority under existing statutes to purchase securities issued by agencies or instrumentalities of the U.S. government if they are issued in such form as may only be held in book-entry accounts of the Federal Reserve Bank by (and transferred between) member banks, if the member bank gives TCDRS its safekeeping receipt or a statement of account acknowledging TCDRS as beneficial owner?

Respectfully yours,


Giles Dalby, Chairman
Board of Trustees

⁴TCDRS owns "Treasury Direct" bonds, there being no intermediary between the Federal Reserve Bank, in its capacity as securities depository, and its capacity as custodian for TCDRS, as authorized by §845.305(b), Government Code.